

**Appeals Complied With the Legal
Requirements for Collection Due Process
and Equivalent Hearings**

July 2003

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DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

INSPECTOR GENERAL
for TAX
ADMINISTRATION

July 31, 2003

MEMORANDUM FOR CHIEF, APPEALS

Gordon C. Milbourn

FROM: Gordon C. Milbourn III
Assistant Inspector General for Audit (Small Business and
Corporate Programs)

SUBJECT: Final Audit Report - Appeals Complied With the Legal
Requirements for Collection Due Process and Equivalent
Hearings (Audit # 200210041)

This report presents the results of our review of the office of the Chief, Appeals' compliance with the law for lien and levy appeal hearing cases. The overall objective of this review was to determine whether the Internal Revenue Service (IRS) complied with the provisions of 26 U.S.C. §§ 6320 and 6330¹ when taxpayers exercised their right to appeal the filing of a lien or the intent to levy. The Treasury Inspector General for Tax Administration is required to determine annually whether the IRS complied with the legal guidelines and required procedures for the filing of a notice of lien or a notice of intent to levy and the right of the taxpayer to appeal.²

In summary, the Appeals Officers and Settlement Officers (hearing officers) were in compliance with the requirements of the law when conducting Collection Due Process (CDP) hearings and Equivalent Hearings (EH). The hearing officers appropriately verified that the IRS followed the applicable laws or administrative procedures during the lien and levy process. They considered the challenges the taxpayers raised and determined whether the proposed collection actions properly balanced the need for efficient collection of taxes with any legitimate taxpayer concerns. The hearing officers addressed these provisions in the CDP determination letters and the EH decision letters. In addition, the hearing officers followed guidelines from the Appeals manual by including information such as in which court the taxpayers must file their request for

¹ 26 U.S.C. §§ 6320 and 6330 (Supp. IV 1998).

² 26 U.S.C. §§ 7803(d)(1)(A)(iii) and (iv) (Supp. IV 1998).

judicial review, as well as information about any agreements reached during the hearing, and any subsequent actions to be taken by the IRS or the taxpayer.

However, in 2 (4 percent) of the 50 EH cases we reviewed, the hearing officers did not provide the taxpayers with the appropriate hearing. The hearing officers provided an EH instead of the required CDP hearing. As a result, the taxpayers may have been denied certain rights available through the CDP hearing process. Appeals management has initiated actions to help assure that the hearing officers properly classify each taxpayer's hearing request.

We estimate that in 35 percent of the CDP and 44 percent of the EH cases, the hearing officers did not document in taxpayers' correspondence that they had no prior involvement with the tax liability under review. Because the impartiality of the hearing officer is a legal requirement, documentation that the hearing officer had no prior involvement with the unpaid tax liability under review should always be included in the CDP determination letters and EH decision letters provided to taxpayers. Without adequate documentation in these letters, there is no file evidence to inform the taxpayer and any reviewing court that the hearing officer had no prior involvement with the unpaid tax liability under review and, therefore, could provide an impartial hearing. Neither was there a clear definition of when a hearing officer would not be impartial due to prior involvement.

Finally, the hearing officers did not describe the taxpayers' rights to further judicial review in the 50 EH decision letters reviewed. While the taxpayers provided an EH do not have the same basic appeal rights available after a CDP hearing, those taxpayers still can appeal the EH decision to the Federal Tax Court in cases where there was a spousal defense or where the taxpayer disagreed with the hearing officer's timeliness determination for a CDP hearing. Without adequate disclosure in the EH decision letter, the taxpayers might be unaware of available due process.

We recommended that the Chief, Appeals, include in the Appeals manual a requirement that the hearing officers document that they had no prior involvement with the tax liability under review in the EH decision letters and that the Appeals Quality Measurement System (AQMS) evaluate whether the hearing officers adequately documented prior involvement in both the CDP determination letters and the EH decision letters. We recommended that Appeals expand the definition of no prior involvement to include prior involvement in compliance activities as well as involvement in Appeals. We also recommended that Appeals include in the Appeals manual a requirement that the hearing officers explain the taxpayer's right to a judicial review.

Management's Response: The Chief, Appeals, agreed to our recommendations. Appeals management agreed that by law, Appeals' hearing officers must not have prior involvement unless there is a waiver, as this may indicate a lack of impartiality. Appeals agreed that their present Internal Revenue Manual (IRM) instructions concerning documentation of prior involvement on EH cases and CDP cases could benefit from further clarification. In addition, Appeals agreed it would be helpful to clarify in the IRM that prior involvement may also include actions on the applicable tax periods while the

case is in Compliance as well as other prior Appeals considerations. To ensure taxpayers are fully informed of their rights to further judicial review, Appeals will further emphasize in their IRM instructions that whenever it is applicable, such as when timeliness or spousal defenses are issues, the decision letter attachments must state the applicable time periods and correct courts to commence judicial action. Appeals will also clarify review items in the AQMS that they use to monitor documentation of prior involvement on CDP determination letters and EH decision letters issued after notification of these clarifications. Also, Appeals will issue interim instructions concerning these clarifications to its employees because revisions, clearance, and publishing of the IRM can take some time. Management's complete response to the draft report is included as Appendix VI.

Copies of this report are also being sent to the IRS managers who are affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Daniel R. Devlin, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.

**Appeals Complied With the Legal Requirements for
Collection Due Process and Equivalent Hearings**

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Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

Background

When initial contacts by the Internal Revenue Service (IRS) do not result in the successful collection of unpaid taxes, the IRS has the authority to attach a claim to the taxpayer's assets for the amount of unpaid tax liability.¹ This claim is commonly referred to as a "lien." The IRS also has the authority to work directly with financial institutions and other parties to obtain from them funds that are owed to the taxpayer.² This procedure is commonly referred to as a "levy."

Since January 19, 1999, the IRS has been required to notify taxpayers in writing when a Notice of Federal Tax Lien has been filed and to let taxpayers know of its intent to levy.³ The taxpayers may appeal the lien or levy action through Collection Due Process (CDP) by filing a written request for a hearing to the IRS within 30 days of the date of the lien or levy notice. If the request is filed on time, Appeals provides the taxpayer a CDP hearing and issues a CDP determination letter or a summary notice of determination.⁴ If the taxpayer does not meet the 30-day filing requirement, Appeals grants an Equivalent Hearing (EH) and issues an EH decision letter. The EH is similar to the CDP hearing except that, under the EH process, the taxpayer is not afforded the same rights granted to taxpayers who qualified for the CDP hearing.

When a taxpayer requests a hearing to appeal the lien or levy action, an impartial Appeals Officer or Settlement Officer (hearing officer) should conduct the appeal proceedings. According to the statute, an impartial hearing officer would have no prior involvement with respect to the unpaid tax liability under review. The taxpayer is entitled to only one hearing for the tax period covered by the lien or levy. Once the IRS receives a hearing request, all tax collection efforts are suspended until Appeals issues its

¹ 26 U.S.C. § 6321 (1994).

² 26 U.S.C. § 6331 (1994 and Supp. IV 1998).

³ Treas. Reg. § 301.6320 and § 301.6330 (January 18, 2002).

⁴ Summary Notice of Determination, Waiver of Right to Judicial Review of a CDP Determination, and Waiver of Suspension of Levy Action (Form 12257).

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determination to the taxpayer. However, under the EH process, the IRS may continue collection efforts.

During a CDP hearing and EH, the hearing officer must determine that the IRS followed all applicable laws or administrative procedures related to the lien or levy. Once this is determined, the taxpayer may raise any issue relevant to the unpaid tax or the proposed levy, such as an appropriate spousal defense, a challenge to the appropriateness of the collection actions, and other collection alternatives. However, the taxpayer may not raise an issue that was considered at a prior administrative or judicial hearing as long as the taxpayer participated meaningfully in the prior proceeding.

After considering the issues and whether the proposed collection action balances efficient tax collection with the taxpayer's legitimate concerns, Appeals issues a CDP determination letter or an EH decision letter to the taxpayer. Both letters present the hearing officer's findings and decisions, agreements reached with the taxpayer, any relief given the taxpayer, and any actions the taxpayer and the IRS are required to take. The CDP determination letter also provides an explanation of the right to appeal the IRS' decision within 30 days of the date of the Appeals determination by filing a petition or complaint in the appropriate Tax Court or U.S. District Court. A synopsis of the IRS collection process, lien and levy filing procedures, the CDP, and the EH process is included in Appendix V.

The Treasury Inspector General for Tax Administration (TIGTA) is required to determine annually whether the IRS complied with the legal guidelines and required procedures for the filing of a notice of lien or a notice of intent to levy and the right of the taxpayer to appeal.⁵ This is the third audit conducted by the TIGTA of Appeals' compliance with the CDP guidelines and procedures. In the last audit, we reported that the IRS generally complied with the requirements of the law and ensured that the taxpayers' appeal rights were protected for the CDP cases reviewed. However, we noted that the CDP determination letters did

⁵ 26 U.S.C. §§ 7803(d)(1)(A)(iii) and (iv) (Supp. IV 1998).

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Appeals Officers and Settlement Officers Complied With the Law When Conducting Collection Due Process and Equivalent Hearings

not always provide taxpayers with an adequate description of the provisions of the law considered in the decision and that Appeals did not always follow IRS guidelines.⁶

We performed this audit in the National Headquarters of the Chief, Appeals, in Washington, D.C., from August 2002 to May 2003. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.

The hearing officers complied with the requirements of 26 U.S.C. §§ 6320 and 6330⁷ when conducting CDP hearings and EHs. In the 121 CDP and EH cases we sampled that resulted in a hearing decision,⁸ the hearing officers appropriately considered the following provisions of the law:

- Obtained verification that the IRS followed the applicable laws or administrative procedures during the lien and levy process.
- Considered the specific challenges raised by the taxpayer.
- Considered whether the proposed collection actions properly balanced the need for efficient collection of taxes with any legitimate concerns of the taxpayer about the intrusiveness of the liens or levies.

The hearing officers appropriately addressed these provisions in the CDP determination letters and EH decision letters, and related support documents, as required in the Code of Federal Regulations.⁹ In addition, the hearing officers followed the Appeals manual guidelines by including information about any agreements reached during the hearing and any subsequent actions to be taken by the

⁶ *Appeals Is Generally Complying With the Requirements of the Law for Lien and Levy Appeals Cases* (Reference Number 2002-10-068, dated March 2002).

⁷ 26 U.S.C. §§ 6320 and 6330 (Supp. IV 1998).

⁸ The 121 cases consisted of 71 CDP and 50 EH cases.

⁹ Treas. Reg. § 301.6330-1(e)(Q-E8) (January 18, 2002).

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IRS. The hearing officers also appropriately included information in the CDP determination letter concerning in which court the taxpayers must file their request for judicial review.

Appeals provided the necessary guidance to assist the hearing officers in conducting CDP hearings and EHs. For example, in November 2001, Appeals consolidated its general guidance in the Appeals Case Memo (ACM)/Determination Letter Guide that includes instructions on formally documenting the CDP and EH process. Appeals also discussed CDP determination letters in presentations at its last annual Continuing Professional Education Conference in Fiscal Year (FY) 2002.

Some Taxpayers Who Were Entitled to Collection Due Process Hearings Were Given Equivalent Hearings

The hearing officers did not always provide taxpayers with the appropriate hearing. In 2 (4 percent) of the 50 EH cases we reviewed, the hearing officers provided the taxpayer an EH instead of the required CDP hearing.¹⁰ As a result, the taxpayers may have been denied certain rights available to taxpayers through the CDP hearing process. There were a total of 2,747 EH cases on the Appeals Centralized Database System (ACDS) closed from May 1, 2002, through August 12, 2002. Based on the composition of our sample, we estimate that 1,717 of the EH cases on the ACDS resulted in EH decisions. Projected to that population, 69 taxpayers may have been improperly denied the CDP.

With CDP, once the taxpayer files a timely request for a hearing, the lien and levy collection process is suspended until the CDP hearing is complete. Also, once the CDP hearing is complete and the Appeals CDP determination letter is issued, the taxpayer still has the right to appeal that decision to the Federal Tax Court. These rights may not be provided to taxpayers inappropriately placed under the EH process. For EH cases, the collection process may continue and the taxpayer can appeal the decision to the Federal Tax Court only if there was a spousal defense or the taxpayer

¹⁰ We sampled a total of 80 cases coded as EHs. However, only 50 resulted in a formal EH decision.

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disagreed with the timeliness decision used to deny a CDP hearing.

In 2 of the 50 cases sampled, the hearing officers incorrectly excluded taxpayers from the CDP.

In the first case, the hearing officer incorrectly used the date of a reminder notice¹¹ instead of the CDP notice to determine timeliness. If the hearing officer had used the CDP notice, the taxpayer's request for a hearing¹² would have been deemed timely, thereby qualifying for a CDP hearing.

In the second case, the hearing officer improperly disallowed a CDP hearing request due to timeliness. The taxpayer's representative timely requested a CDP hearing. However, since the IRS did not have a Power of Attorney and Declaration of Representative (Form 2848) on file, the CDP hearing request was returned to the taxpayer's representative for correction. The taxpayer and representative later filed the Form 2848 and returned the CDP hearing request. However, contrary to the instructions, the hearing officer did not use the original CDP hearing request submission date as the basis for determining timeliness. Since the original CDP hearing request was filed timely, within the prescribed 30-day time period, the hearing officer should have granted the taxpayer a CDP hearing.

Although collection actions could have been taken for these two cases, the IRS Integrated Collection System indicated that no collection actions were taken after the cases were forwarded to Appeals. As a general rule, even when not required by statute, the IRS suspends its levy action during the appeals process unless the collection is at risk. Nevertheless, if CDP cases are incorrectly classified as EH cases, inappropriate collection actions could inadvertently continue. For example, actions under the automated levy programs such as the Federal payment levy would not be suspended during the EH process.

¹¹ Reminder Notice (Form Letter 3328) - This notice is used to remind taxpayers of any overdue taxes.

¹² Request for a Collection Due Process Hearing (Form 12153).

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Appeals management took actions to help assure that the hearing officers were properly classifying the taxpayers' hearing requests. In its manual, Appeals provided guidance on how to determine the timeliness of CDP hearing requests. Appeals made its manual available to all Appeals employees on its website.

In June 2002, Appeals established a new "Screener Position" to review cases referred to Appeals for a hearing. Screeners determine whether the taxpayer's hearing request qualifies for a CDP hearing or an EH. Prior to the establishment of the screener position, the hearing officer alone made that determination for Appeals. Appeals has 28 case screeners in 8 of 9 area offices. The original plan was to hire 50 screeners; however, Appeals was not able to add any additional positions due to the hiring freeze imposed in September 2002. The existing screener positions coupled with the other Appeals actions should improve the hearing officers' classification of CDP and EH cases.

Taxpayers Were Not Always Informed of the Appeals Officer's or Settlement Officer's Involvement

The law provides that each taxpayer is entitled to a hearing before a hearing officer who had no prior involvement with respect to the particular tax liability under review.¹³ In 25 of the 71 CDP and 22 of the 50 EH cases we reviewed, the documents provided the taxpayers did not indicate that the hearing officer had no prior involvement with the unpaid tax liability under review. As a result, out of the total population of 9,095¹⁴ CDP and EH cases on the ACDS with and without CDP determination letters issued between May 1, 2002, and August 12, 2002, we estimate that the hearing officers did not document that they had no prior involvement with the tax liability 35 percent of the time in CDP determinations and 44 percent of the time in EH decisions. Projected to the population, we estimate that the

¹³ An impartial hearing officer should conduct the appeal proceedings. According to the statute, to be impartial, a hearing officer would have no prior involvement with respect to the unpaid tax liability under review. The taxpayer may waive this requirement by filing a Waiver Form for Right to Request a New Settlement Officer/Appeals Officer under Section 6320 and/or 6330 (Form 12218).

¹⁴ The 9,095 cases consisted of the 6,348 CDP cases and 2,747 EH cases.

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hearing officers did not document their prior involvement in 2,991 cases.

The Appeals manual and the ACM/Determination Letter Guide for CDP hearings instruct the hearing officers to include a statement in the CDP determination letter outlining that they had no prior involvement in the tax periods under review. The reference guide, as an aid for the hearing officers, references the Appeals manual requirements and provides additional suggestions for preparing the CDP determination letters and the EH decision letters. The Appeals manual did not require the hearing officers to document their prior involvement in the EH correspondence; however, the regulations¹⁵ did state that the EH decision letter should contain the same basic information as the CDP determination letters.

The Appeals Quality Measurement System (AQMS) provides Appeals managers with data on the quality of their cases, including CDP and EH cases. As part of their review, AQMS reviewers evaluate whether the hearing officers had prior involvement in the CDP or the EH case. In FY 2002, AQMS identified 252 out of 1,220 CDP cases where files did not document the prior involvement of the hearing officer. The reviewers determined prior involvement by reviewing information in the entire case file that might include the CDP determination letters and the EH decision letters. However, reviewers were not required by AQMS procedures to determine whether the hearing officers specifically documented in those letters that they had no prior involvement with the tax liability under review.

In addition, Appeals did not have a clear definition on when a hearing officer would not be impartial due to prior involvement and should exclude him or herself from the proceedings. Appeals guidance on prior involvement was limited to hearing officers' participation or involvement in an Appeals hearing other than a CDP hearing under the provision of the law.¹⁶ However, this definition appears to

¹⁵ Treas. Reg. §§ 301.6320-1(i)(A-I4) and 6330-1(i)(A-I4) (January 18, 2002).

¹⁶ 26 U.S.C. §§ 6320 and 6330 (Supp. IV 1998).

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be incomplete as the statute covers involvement with the “unpaid tax liability” which, for example, would also include prior involvement with compliance activities outside of Appeals.

Because the impartiality of the hearing officer is a legal requirement, the documentation of no prior involvement should always be included in the CDP determination letters and the EH decision letters provided to taxpayers. Without that documentation, there is no file evidence to inform the taxpayer and any reviewing court that the hearing officer had no prior involvement with the unpaid tax liability under review and, therefore, could provide an impartial hearing. Without an independent means to verify whether there was no prior involvement, Appeals needs to assure that the hearing officers adequately consider their standing with the taxpayer and that they are clear on what constitutes no prior involvement.

Recommendations

The Chief, Appeals, should:

1. Require in the Appeals manual that the hearing officers document in the EH decision letters their prior involvement with the tax liability under review.

Management’s Response: Appeals will revise the Appeals Internal Revenue Manual (IRM) instructions to specify that Appeals employees document on the EH decision letter their prior involvement with the tax liability under review. In addition, pending completion of the IRM revision and publication, Appeals will also issue interim guidance.

2. Require the AQMS to revise its evaluation process to verify that the hearing officers consider and document that they had no prior involvement in both the CDP determination letters and the EH decision letters.

Management’s Response: Appeals will revise the AQMS evaluation process to ensure no prior involvement, or a waiver of such involvement, is documented in the CDP determination letter or the EH decision letter.

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3. Expand the Appeals definition of no prior involvement to include prior involvement in compliance activities as well as involvement in Appeals hearings.

Management's Response: Appeals will revise the Appeals IRM instructions to specify that prior involvement include Compliance activities as well as Appeals hearings. In addition, pending completion of the IRM revision and publication, Appeals will also issue interim guidance.

Taxpayer Rights to Judicial Review Were Not Disclosed in the Equivalent Hearing Decision Letters

Of the 50 EH cases reviewed, the hearing officers did not describe the taxpayer's right to further judicial review in any of the EH decision letters.¹⁷ While the taxpayers provided an EH do not have the same basic rights available after a CDP hearing, those taxpayers still can appeal the EH decision to the Federal Tax Court in cases where there was a spousal defense or where the taxpayer disagreed with the hearing officer's timeliness determination for a CDP hearing. However, the hearing officers were not routinely advising the taxpayers in EH decision letters of their rights under the EH process to a subsequent judicial review. The Appeals manual and reference guide did not require the hearing officers to formally disclose those rights to the taxpayer in the EH decision letter.

As a result, the taxpayers might be unaware of available due process. There were a total of 2,747 EH cases on the ACDS closed from May 1, 2002, through August 12, 2002. Based on the results of our sample, possibly all of the taxpayers provided an EH decision letter were not made aware of subsequent rights for a judicial review. Of the total EH cases in the population, we estimate that 1,717 resulted in EH decisions.

¹⁷ We sampled a total of 80 cases coded as EHs. However, only 50 resulted in a formal EH decision.

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Recommendation

The Chief, Appeals, should ensure that:

4. The Appeals manual and reference guide require the hearing officers to explain in EH decision letters the taxpayer's right to a subsequent judicial review.

Management's Response: Appeals will revise the IRM and reference guide to clarify that when timeliness or spousal defenses are raised as issues, they will be discussed in the attachment to the decision letter. Taxpayers will be advised in the attachment to the decision letter of the 30-day period to file a judicial action on timeliness issues and of the 90-day period to file a judicial action on spousal defenses issues, when applicable. In addition, pending completion of the IRM revision and publication, Appeals will also issue interim guidance to remind employees to comply with this existing procedure.

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Appendix I

Detailed Objective, Scope, and Methodology

The objective of this audit was to determine if the Internal Revenue Service (IRS) complied with 26 U.S.C. §§ 6320 and 6330¹ when taxpayers exercised their right to appeal the filing of a lien or the intent to levy.

- I. To determine if the corrective actions from the prior report were implemented, we interviewed Appeals employees and obtained the pertinent documentation.
- II. To determine if the IRS was in compliance with 26 U.S.C. §§ 6320 and 6330 and the IRS guidelines in cases resulting in the issuance of formal Appeals Collection Due Process (CDP) determination letters, we:
 - A. Selected a statistical sample of 58 CDP cases with determination letters closed from May 1, 2002, through August 12, 2002, from a download of 4,895 case inventory records controlled on the Appeals Centralized Database System (ACDS) for the purpose of projecting the sample results to the entire population. We used attribute sampling and the following formula to calculate the sample size (n) for the CDP cases with determinations letters:

$$n = (NZ^2p(1-p))/(E^2+Z^2p(1-p)).$$

N = Population (4,895 CDP cases).
Z = Desired Confidence Level (90 percent).
p = Expected Error Rate (2 percent).*
E = Precision Level (3 percent).

* 2 percent was the error rate in the last audit.

We statistically selected 13 additional cases that were closed from May 1, 2002, through August 12, 2002, with summary determination letters from a download of 1,453 other inventory records controlled on the ACDS. These 13 cases and the 58 cases in our initial sample made up the total sample of 71 CDP cases.

NOTE: We used CDP inventory records provided by Appeals and did not determine if the data from the ACDS were complete and accurate.

- B. Reviewed the selected cases to determine whether Appeals Officers and Settlement Officers complied with 26 U.S.C. §§ 6320 and 6330 and related regulations and whether taxpayers' rights were protected.

¹ 26 U.S.C. §§ 6320 and 6330 (Supp. IV 1998).

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III. To determine if the IRS was in compliance with 26 U.S.C. §§ 6320 and 6330 and the IRS guidelines in cases where Appeals issued an Equivalent Hearing (EH) decision letter, we:

A. Selected a random sample of 80 EH cases out of a population of 2,747 case inventory records on the ACDS that were closed from May 1, 2002, through August 12, 2002, for the purpose of projecting the sample results to the entire population. We used attribute sampling and the following formula to calculate the sample size (n):

$$n = (NZ^2p(1-p))/(NE^2+Z^2p(1-p)).$$

N = Population (2,747 EH cases).

Z = Desired Confidence Level (90 percent).

p = Expected Error Rate (8.3 percent).*

E = Precision Level (5 percent).

*Error rate based on our initial probe sample (2 errors/24 cases
in the probe sample = .083 percent error rate).

B. Determined that 50 of the 80 EH cases resulted in a formal EH decision and reviewed those cases to determine whether Appeals Officers and Settlement Officers complied with 26 U.S.C. §§ 6320 and 6330 and related regulations and whether taxpayers' rights were protected.

C. Discussed examples of cases that appeared to be potential violations with the Treasury Inspector General for Tax Administration Office of Chief Counsel.

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Appendix III

Report Distribution List

Commissioner N:C
Deputy Commissioner for Services and Enforcement N:SE
Director, Appeals, Small Business/Self-Employed Division – Tax Exempt & Government
Entities Operating Unit AP
Director, Taxpayer Account Operations TA:TAO
Chief Counsel CC
National Taxpayer Advocate TA
Director, Legislative Affairs CL:LA
Director, Office of Program Evaluation and Risk Analysis N:ADC:R:O
Office of Management Controls N:CFO:AR:M
Audit Liaison: Chief, Appeals AP

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Appendix IV

Outcome Measures

This appendix presents detailed information on the measurable affect that our recommended corrective actions will have on tax administration. These benefits will be incorporated into our Semiannual Report to the Congress.

Type and Value of Outcome Measure:¹

- Taxpayer Rights and Entitlements –
 - Potential; 69 cases where the hearing officers could have deprived taxpayers of certain basic rights available through the Collection Due Process (CDP) (see page 4).
 - Potential; 2,991 cases where the hearing officers did not document their prior involvement in the CDP determination letter or the Equivalent Hearing (EH) decision letter (see page 6).
 - Potential; 1,717 cases where the hearing officers did not advise taxpayers of their right to a judicial review in the EH decision letters (see page 9).

Methodology Used to Measure the Reported Benefit:

From our nationwide statistically valid sample of 80 EH cases:²

- We identified 2 (4 percent) of the 50 EH cases where the hearing officers did not provide the taxpayers with the appropriate hearing. As a result, the taxpayers may have been denied certain rights available through the CDP hearing process. There were a total of 2,747 EH cases on the Appeals Centralized Database System (ACDS) closed from May 1, 2002, through August 12, 2002. Based on the composition of our sample, we estimate that 1,717 of those cases resulted in EH decisions ($50/80 \times 2,747$). Projected to that population, 69 taxpayers may have been improperly denied the CDP ($2/50 \times 1,717$). We are 90 percent confident that between 2 and 147 taxpayers were improperly denied the CDP.
- The hearing officers did not document that they had no prior involvement with the liability under review in 25 of the 71 CDP³ cases and 22 of the 50 EH cases reviewed. As

¹ The total of 4,777 taxpayer accounts is likely to contain duplicates since each of the 3 findings were projected to the same database.

² The sample of 80 EH cases was taken from a population of 2,747 cases on the Appeals Centralized Database System closed with an EH code between May 1, 2002, and August 12, 2002. Our review disclosed that 30 cases (37.5 percent) were not actually EH cases.

³ The 71 CDP cases consisted of 58 cases with CDP determination letters and 13 cases closed with summary determination letters.

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a result, out of the total population of 9,095⁴ cases on the ACDS with and without CDP determination letters issued between May 1, 2002, and August 12, 2002, we estimate that the hearing officers did not document that they had no prior involvement with the tax liability under review 35 percent of the time in CDP determinations and 44 percent of the time in EH decisions. Projected to the population, we estimate that the hearing officers did not document their prior involvement in 2,991 cases. We are 90 percent confident that the number of cases in which the hearing officers did not document their prior involvement is between 2,357 and 3,625 cases.

- The hearing officers did not advise taxpayers of their right to a judicial review in all of the cases sampled where taxpayers were issued an EH decision letter. Since only 50 of the 80 EH cases sampled actually resulted in an EH decision letter, we estimate that for the 2,747 EH cases on the ACDS closed between May 1, 2002, and August 12, 2002, in possibly 1,717 cases ($50/80 \times 2,747$) the taxpayers were not made aware of their right to a judicial review in the EH decision letter.

⁴ The 9,095 cases consisted of the 6,348 CDP cases and 2,747 EH cases.

**Synopsis of the Internal Revenue Service
Collection Process, Lien and Levy Filing Procedures,
Collection Due Process, and Equivalent Hearing Process**

The collection of unpaid tax begins with a series of letters (notices) sent to the taxpayer advising of the debt and asking for payment of the delinquent tax. The Internal Revenue Service (IRS) computer systems are programmed to mail these notices when certain criteria are met. If the taxpayer does not respond to the notice, the account is transferred for either personal or telephone contact.

- The IRS employees who make personal (face-to-face) contact with taxpayers are called Revenue Officers and work in the IRS field offices. The computer system used in most of the field offices to track collection actions taken on taxpayer accounts is called the Integrated Collection System.
- The IRS employees who make only telephone contact with taxpayers are called Customer Service Representatives and work in call sites in the IRS Customer Service offices. The computer system used in the call sites to track collection actions taken on taxpayer accounts is called the Automated Collection System.

When contacts are made and the taxpayer still does not pay the tax liability, designated IRS employees are authorized to file a Notice of Federal Tax Lien (NFTL). In addition, the IRS has the authority to work directly with financial institutions and other parties to obtain funds owed to taxpayers. The taking of money owed to a taxpayer by a third party is commonly referred to as a levy.

Federal Tax Lien

Liens protect the Federal Government's interest by attaching a claim to the taxpayer's assets for the amount of unpaid tax liability. The right to file a NFTL is created under 26 U.S.C. § 6321 (1994) when:

- The IRS has made an assessment and given the taxpayer notice of the assessment, stating the amount of the tax liability and demanding payment.
- The taxpayer has neglected or refused to pay the amount within 10 days after the notice and demand for payment.

The IRS is required to notify the taxpayer the first time a NFTL is filed for each tax period. It has to notify the taxpayer within 5 days after the lien notice filing. The taxpayer then has 30 days, after that 5-day period, to request a hearing with the Chief, Appeals.

Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

Levy

A levy is a legal seizure of property to satisfy a tax debt. Levies are different from liens. A lien is a claim used as security for the tax debt, while a levy actually takes the property to satisfy the tax debt. The IRS authority to work directly with financial institutions and other parties to obtain funds owed to taxpayers is provided under 26 U.S.C. § 6331 (1994 and Supp. IV 1998).

The IRS usually does not levy unless:

- It has made an assessment and given the taxpayer notice of the assessment, stating the amount of the tax liability and demanding payment.
- It has sent a Final Notice of Intent to Levy and a Notice of Right to Hearing (levy notice) at least 30 days before the levy action. This 30-day period allows the taxpayer time to solve any problems created by the levy or to make other arrangements to pay.

For each tax period, the IRS is required to notify the taxpayer the first time it intends to collect a tax liability by taking the taxpayer's property or rights to property. It does this by sending the taxpayer a levy notice. The IRS cannot levy on or seize property within 30 days from the date this notice is mailed, given to the taxpayer, or left at the taxpayer's home or office. During that 30-day period, the taxpayer may request a hearing with the Chief, Appeals.

There are two exceptions to the notice of intent to levy provision. The IRS may issue a levy without sending a notice or waiting 30 days when collection of the tax is in jeopardy. The IRS may also levy on a taxpayer's State tax refund without sending a notice or waiting 30 days. However, the taxpayer can request a hearing after the levy action for both of these instances.

Collection Due Process and Equivalent Hearing Process

The IRS is required under 26 U.S.C. §§ 6320 and 6330 (Supp. IV 1998) to notify taxpayers in writing that a NFTL has been filed and to let the taxpayers know of its intent to levy. If the taxpayer elects to appeal the lien or levy action, he or she must submit a request for a Collection Due Process (CDP) hearing in writing within the time prescribed by the law. If the taxpayer does not meet the 30-day CDP filing requirement, Appeals grants an Equivalent Hearing (EH) and issues an EH decision letter. The EH is similar to the CDP hearing except that the taxpayer is not afforded the same rights granted to taxpayers who qualify for a CDP hearing.

Taxpayers are entitled to one hearing per tax liability period for which a NFTL or intent to levy has been filed. A hearing officer with no prior involvement with the unpaid tax conducts the hearing. However, at the taxpayer's discretion, this requirement may be waived.

Unless the IRS believes that collection of the tax is in jeopardy, the IRS will postpone the levy action during the appeals process. In addition, under the CDP hearing process only, the IRS will also suspend the 10-year collection statute of limitations during the appeal process and until the determination is final.

Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

At the appeal, the taxpayer may raise any relevant issue related to the unpaid tax or the proposed levy, including:

- Spousal defenses.
- The appropriateness of collection actions.
- Other collection alternatives.
- The existence or amount of the tax but only if the taxpayer did not receive a notice of deficiency for that liability or did not have an opportunity to dispute the tax liability.

An issue may not be raised if the taxpayer participated meaningfully in any previous administrative or judicial proceeding where the same issue was already raised and considered.

During the appeal, the hearing officer must:

- Obtain verification from the IRS that the requirements of any applicable law or administrative procedure have been met.
- Consider the specific challenges raised by the taxpayer.
- Consider whether the proposed collection action properly balances the need for efficient collection of taxes with any legitimate concern of the taxpayer that the proposed collection action is more intrusive than necessary.

At the conclusion of the hearing, Appeals will provide a written document to the taxpayer informing him or her of the Appeals determination. For a timely filed hearing request, Appeals will issue a CDP determination letter or Summary Notice of Determination, Waiver of Right to Judicial Review of a CDP Determination, and Waiver of Suspension of Levy Action (Form 12257). However, for an untimely hearing request, Appeals issues an EH decision letter. All three documents explain Appeals' findings and decisions, any relief given the taxpayer, and any actions the taxpayer and/or the IRS are required to take. However, only the CDP determination letter informs the taxpayer that he or she may seek judicial review of an Appeals determination in the Federal Tax Court or U.S. District Court by filing a petition or complaint in the appropriate court within 30 days of the date of the Appeals determination. If the court determines that the appeal was made to the incorrect court, the taxpayer has 30 days after the court's determination to file the appeal with the correct court. Appeals will retain jurisdiction over its determinations and how they are carried out. The taxpayer may also return to Appeals if circumstances change and affect the original determination.

The Form 12257 also explains Appeals' findings and decisions, but it confirms that the taxpayer agrees with the Appeals determination, waives his or her rights to judicial review of the Appeals determination, and waives the suspension of levy action. In all three documents provided to the taxpayers, the hearing officer must demonstrate that he or she complied with all the requirements of 26 U.S.C. §§ 6320 and 6330.

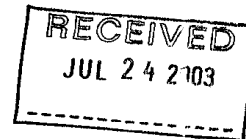
**Appeals Complied With the Legal Requirements for
Collection Due Process and Equivalent Hearings**

Appendix VI

Management's Response to the Draft Report



DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224



July 17, 2003

MEMORANDUM FOR TREASURY INSPECTOR GENERAL FOR
TAX ADMINISTRATION

FROM: David B. Robison *David B Rob*
Chief, Appeals

SUBJECT: Draft Audit Report – Appeals Complied With the Legal
Requirements for Collection Due Process and
Equivalent Hearings (Audit # 200210041)

I reviewed your draft report and am pleased that you found Appeals is complying with the legal requirements for Collection Due Process (CDP) and Equivalent Hearings (EH). Appeals is committed to effectively and fairly offer due process hearings as required by the Internal Revenue Service Restructuring and Reform Act of 1998, Section 3401, so I appreciate your suggestions for improvement.

By law, Appeals' hearing officers must not have prior involvement unless there is a waiver, as this may indicate lack of impartiality. We agree that our present Internal Revenue Manual (IRM) instructions concerning documentation of prior involvement on EH cases and CDP cases could benefit from further clarification. In addition, we agree it would be helpful to clarify in the IRM that prior involvement may also include actions on the applicable tax periods while the case is in Compliance as well as other prior Appeals considerations. To ensure taxpayers are fully informed of their rights to further judicial review, we will further emphasize in our IRM instructions that whenever it is applicable, such as when timeliness or spousal defenses are issues, the decision letter attachments must state the applicable time periods and correct courts to commence judicial action. We will also clarify review items in the Appeals Quality Measurement System (AQMS) that we use to monitor documentation of prior involvement on CDP determination letters and EH decision letters issued after notification of these clarifications. Also, because revisions, clearance, and publishing of the IRM can take some time, we will issue interim instructions concerning these clarifications to our employees.

Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

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We will address your specific recommendations as follows:

IDENTITY OF RECOMMENDATION/FINDING

The Chief, Appeals should:

1. Require in the Appeals manual that the hearing officers document in the EH decision letters their prior involvement with the tax liability under review.

CORRECTIVE ACTION(S)

- We agree to revise the Appeals IRM instructions to specify that Appeals employees document on the EH decision letter their prior involvement with the tax liability under review.

IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: Dec 31, 2003

- Pending completion of the IRM revision and publication process, we will also issue interim guidance.

IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: July 31, 2003

RESPONSIBLE OFFICIAL(S)

Director, Technical Services, Appeals

CORRECTIVE ACTION(S) MONITORING PLAN

Upon implementation, we will monitor CDP cases through AQMS and operational reviews to determine whether employees are documenting prior involvement on both CDP determination letters and EH decision letters.

IDENTITY OF RECOMMENDATION/FINDING

The Chief, Appeals should:

2. Require AQMS to revise its evaluation process to verify that the hearing officers consider and document that they had no prior involvement in both the CDP determination letters and the EH decision letters.

CORRECTIVE ACTION(S)

The AQMS evaluation process will be revised to ensure no prior involvement, or a waiver of such involvement, is documented in the CDP determination letter or the EH decision letter.

Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

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IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: Cases Closed after July 31, 2003

RESPONSIBLE OFFICIAL(S)

Director, Strategic Planning, Appeals

CORRECTIVE ACTION(S) MONITORING PLAN

Upon implementation, we will monitor CDP cases through AQMS and operational reviews to determine whether employees are documenting prior involvement on CDP determination letters and EH decision letters.

IDENTITY OF RECOMMENDATION/FINDING

The Chief, Appeals should:

3. Expand the Appeals definition of no prior involvement to include prior involvement in compliance activities as well as involvement in Appeals hearings.

CORRECTIVE ACTION(S)

- We will revise the Appeals IRM instructions to specify that prior involvement includes Compliance activities as well as Appeals hearings.

IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: Dec. 31, 2003

- Pending completion of the IRM revision and publication process, we will also issue interim guidance.

IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: July 31, 2003

RESPONSIBLE OFFICIAL(S)

Director, Technical Services, Appeals

CORRECTIVE ACTION(S) MONITORING PLAN

Upon implementation, we will monitor CDP cases through the AQMS and operational reviews to determine whether employees are documenting prior involvement on CDP

Appeals Complied With the Legal Requirements for Collection Due Process and Equivalent Hearings

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determination letters and EH decision letters, and whether any Compliance involvement was also noted.

IDENTITY OF RECOMMENDATION/FINDING

The Chief, Appeals should ensure that:

4. The Appeals manual and reference guide require the hearing officers to explain in EH decision letters the taxpayer's right to a subsequent judicial review.

CORRECTIVE ACTION(S)

- We will revise the IRM and reference guide to clarify that when timeliness or spousal defenses are raised as issues, they will be discussed in the attachment to the decision letter. Taxpayers will be advised in the attachment to the decision letter of the 30-day period to file a judicial action on timeliness issues and of the 90-day period to file a judicial action on spousal defense issues, when applicable.

IMPLEMENTATION DATE:

COMPLETED:

PROPOSED: Dec. 31, 2003

- Pending completion of the IRM revision and publication process, we will also issue interim guidance to remind employees to comply with this existing procedure.

IMPLEMENTATION DATE:

COMPLETED

PROPOSED: July 31, 2003

RESPONSIBLE OFFICIAL(S)

Director, Technical Services, Appeals

CORRECTIVE ACTION(S) MONITORING PLAN

Upon implementation, we will monitor EH cases through the AQMS and operational reviews to determine whether employees are documenting judicial rights on attachments to EH decision letters, when applicable.

If you have any questions, please have a member of your staff call Cheryl Revier, Program Analyst, at (202) 694-1847.